



Financing Real Estate for Mid-Atlantic Businesses

SBA 504 LOAN PROGRAM

FEBRUARY 23, 2016

**For audio portion, please call 888-858-2144
and enter the access code of 4536711#**

**Please MUTE your phones or
use *6 on your keypad.
Thank you!**

ACKNOWLEDGMENT

We would like to thank Beth Wilson for her time and providing information regarding her experience in lending and working on SBA 504 loans from her perspective.





Financing Real Estate for Mid-Atlantic Businesses



Growing Small Businesses, Jobs & Communities

What is 504?

ECONOMIC DEVELOPMENT FINANCING TOOL

- Finances fixed assets for healthy, expanding businesses
- Low down payment to preserve cash to fund growth

COMMUNITY BENEFITS

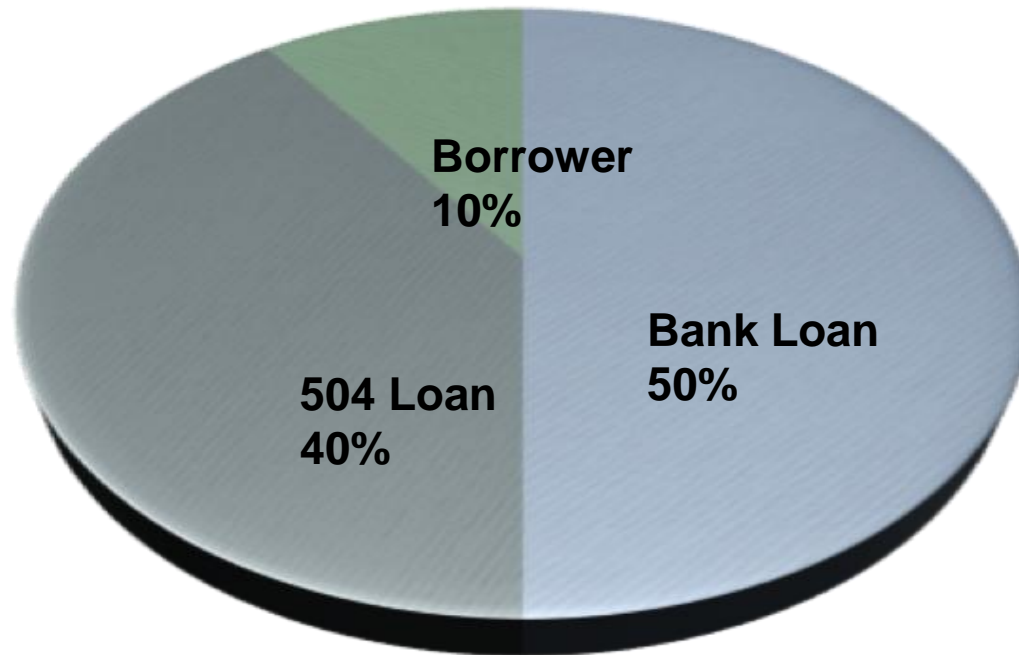
- Jobs created and/or retained
- Increased tax base

DELIVERY SYSTEM




- Delivered by nationwide network of 260 CDCs – typically non-profits with an economic development mission



Typical 504 Structure



**Total Project Costs
\$1,000,000**

	\$500,000	10 Year Maturity. Negotiable Rate
	\$400,000	20 Year Fully Amortized Fixed Rate Bond Market
	\$100,000	Borrower Contribution



504 Source of Funds

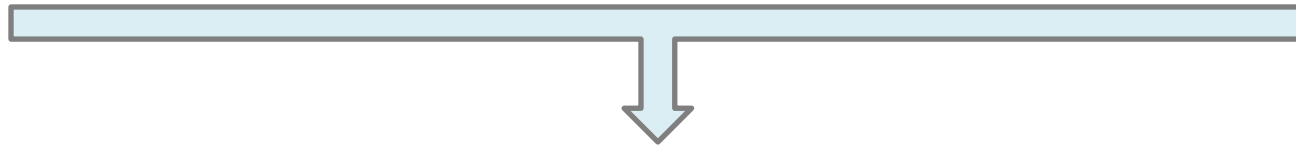
- Bonds sold on Wall Street to institutional investors
 - Life insurance companies
 - Pension plans
 - Mutual funds
 - Interest Rate is based on 10 year treasury rate
 - Plus spread to bond investor
 - Plus servicing fees to SBA, CDC, and SBA's bookkeeping contractor
- * For 504 Refinance Loans add 0.1655% due to increased fees

Interest Rate
4.324%
All-in-fixed for 20years
February 2016
Bond Sale



Fees- Bond Sale Costs

CDC Processing Fee	1.50%
SBA Guarantee Fee	0.50%
Funding Corp Fee	0.25%
Bond Broker Fee	<u>0.40%</u>
TOTAL	2.65%



- Approximately 1% of the total project costs
- Fees are added to the 40% 504 portion and financed over 20 years
- Adds approximately 25 basis points (0.25%) to the 504 interest rate on an “APR” basis
- Bank pays 0.5% fee on 1st trust loan amount



Prepayment Penalty

- Prepayment penalty declines during first 10 years to 0% →
- Loan is assumable and prepayment penalty does not apply

Sample Prepayment Penalty	
<u>Year</u>	<u>%</u>
1	3.00%
2	2.70%
3	2.40%
4	2.10%
5	1.80%
6	1.50%
7	1.20%
8	0.90%
9	0.60%
10	0.30%
11-20	0.00%



Business Eligibility

- ✓ For-Profit & Privately Held
- ✓ “Small”
 - Net Worth < \$15.0 million
 - After Tax Income < \$5.0 million (2 year average)
- ✓ Creates or Retains Jobs*
- ✓ Or meets a public policy or community development goal of SBA

**1 job per \$65,000 in 504 loan dollars*



Eligible Project Costs

Real Estate (owner occupied)

- Existing Buildings
- Addition/Major Renovation
- Land/Building Construction

Machinery and Equipment

- Minimum 10 Year Life
- Printing Press or Manufacturing Equipment

Soft Costs

- Appraisal & Environmental
- Title & Recording Taxes
- Closing Costs, Bank Points

Refinancing

- Permanent 504 Refinance Program – Expansion costs and existing debt (up to 50% of New Costs in Expansion)



Project Eligibility

Occupancy

Existing Building 51%

New Construction 60%

- *20% permanently leased*
- *20% to be occupied in 10 years*

Down Payment

Typical 10%

Start-up 15%

Special Use 15%

Both 20%

Project Size

Min = \$200,000

Max = No max project size

Max 504 Loan:

- *\$5,000,000 for most loans*
- *\$5,500,000 for manufacturers & certain energy efficient projects*

Bank Loan can exceed 50%

Projects could be as large as \$20+ million



504 Loan vs. Conventional Loan

<u>Eligible Project Costs</u>		<u>504 Financing Structure</u>		
Land/Building	500,000	Third Party Lender	\$ 500,000	50%
Renovation	400,000	504 portion	\$ 400,000	40%
Equipment	50,000	Borrower Contribution	\$ 100,000	10%
Soft Costs:		TOTAL SOURCES	\$ 1,000,000	100%
Title Charges	3,500			
Recording Taxes	15,000	<u>Conventional Financing</u>		
Appraisal	3,500	20% of hard costs	\$ 190,000	
Environmental	3,000	Soft Costs	\$ 50,000	
Architect / Engineer	15,000	Borrower Contribution	\$ 240,000	
Bank points	10,000			
TOTAL PROJECT COSTS	\$ 1,000,000	BORROWER SAVINGS WITH 504	\$ 140,000	



Application Items Needed

Essentially same information any commercial lender requires:

- ☒ Tax returns on the business
- ☒ Projections, if start-up business
- ☒ Personal financial statement and tax returns for owners
- ☒ Brief History/description of business and owners' resumes
- ☒ Purchase Contract or Letter of Intent, construction/renovation estimates

How long does it take?

Working with us, 10 days for our approval;

5 days for SBA approval



Credit Underwriting Considerations

<u>CASH FLOW ANALYSIS</u>	<u>12/31/2011</u>
Revenues	\$2,734
Pre-tax earnings	\$1,122
plus depreciation	\$16
plus interest expense	\$0
plus rent savings	\$169
plus officers comp. expense	\$249
CASH FLOW AVAILABLE	\$1,557
Existing Debt Service	\$21
Proposed Debt Service	\$308
Officers' Comp. needed (40% personal D/I ratio)	\$385
CASH FLOW NEEDED	\$714
CASH FLOW MARGIN	\$843
CASH FLOW COVERAGE	2.18

- Proven Management
- Cash Flow Coverage
 - Minimum 1:1 cash flow coverage based on historical operations or projections (if start-up business or rapidly growing business)
 - ← Example of how we calculate cash flow coverage
- NOTE – bank requirements may vary



Credit Underwriting Considerations

- Acceptable Collateral Coverage
- Appraisals must have minimum 2 approaches to value

<u>PROJECT COSTS</u>		<u>MINIMUM APPRAISAL CALCULATION</u>	
Land Purchase	700,000	Total Project Costs	2,800,000
New Construction	1,500,000	less Equipment	300,000
Equipment	300,000	Minimum Required R/E Value	2,500,000
Soft Costs -			
settlement costs	50,000	If needed, SBA allows for a 10% tolerance without changing loan amounts	2,500,000
appraisal & environmental	10,000		(250,000)
contingencies @10%	150,000	Minimum Acceptable R/E Value	2,250,000
interest carry	90,000		
TOTAL PROJECT COSTS	2,800,000		





Financing Real Estate for Mid-Atlantic Businesses

504 REFINANCE LOAN WITH EXPANSION

When is this appropriate?

- Business has existing debt on property and needs a major renovation or expansion
- 504 Project can include all new costs and existing debt (subject to limitations)
 - Existing debt to be rolled into 504 structure is limited to 50% of new costs
 - If existing debt exceeds 50% of new costs, the overage is added to the bank loan AFTER the 504 project is structured



Example 1 – Refinance with Expansion

Appraised Value of Property As-Is	\$1,000,000
Pre-Existing Debt	\$700,000
New Costs	\$2,000,000

<u>Use of Funds</u>		<u>Sources of Funds</u>		
Existing Equity	300,000	Third Party Loan	1,500,000	50%
Pre-Existing Debt	700,000	SBA 504 Loan	1,200,000	40%
New Construction	1,400,000	Borrower Contribution	300,000	10%
Equipment	300,000	TOTAL SOURCES	3,000,000	100%
Soft Costs -				
settlement costs	50,000			
appraisal & environmental	10,000			
contingencies @10%	140,000			
interest carry	100,000			
TOTAL USES	3,000,000			

Note: Existing debt is less than 50% of new costs and is added back to 504 project entirely before the split.



Example 2 – Refinance with Expansion

Appraised Value of Property As-Is

\$1,000,000

Pre-Existing Debt

\$ 800,000 *

New Costs

\$1,200,000

<u>Use of Funds</u>		<u>Sources of Funds</u>		
Existing Equity	200,000	Third Party Loan *	1,000,000	50%
Pre-Existing Debt *	600,000	SBA 504 Loan	800,000	40%
New Construction	900,000	Borrower Contribution	200,000	10%
Equipment	100,000	TOTAL SOURCES	2,000,000	100%
Soft Costs -				
settlement costs	50,000			
appraisal & environ.	10,000			
contingencies @10%	70,000			
interest carry	70,000			
TOTAL USES	2,000,000			

***Note:** Pre-Existing debt exceeds 50% of new costs. So, pre-existing debt added to eligible 504 project cost is limited to \$600,000 (50% of new costs). The remaining \$200,000 in pre-existing debt is added to the bank's 50% loan after the split to create a combined bank loan of \$1,200,000.



What's New in the 504 Loan Program ?

Debt Refinance is now a
PERMANENT PART
of the 504 loan program !



Background

- Small Business Jobs Act signed into law on 9.27.10
- Temporarily allowed the 504 program to refinance existing small business debt without business expansion
- Program very successful but ended 9.27.12 due to temporary nature
- NADCO has been working with Congress to get this program reinstated permanently for the past 3.5 years
- Congress passed the legislation 12-18-15
- SBA will provide final regulations in approximately 6 months
- We anticipate the program will be available to borrowers in the June/July time frame



Eligibility

BASIC ELIGIBILITY

✓	Property must be minimum 51% owner occupied at the time of 504 application
✓	Operating company must be at least 2 years old
✓	Project property must have been acquired minimum 2 years ago with financing. Age of existing loan is irrelevant.
✓	<p>Loan must have been current for last 12 months</p> <ul style="list-style-type: none">• No payment deferred or past due for more than 30 days• Payments must be current under original or modified payments terms. All modifications must have been in writing.• Transcript must be provided to demonstrate compliance
✓	This information may be changed as it is a part of the 2011 debt refi regulations



Eligibility continued:

- ◉ **NO** federal debt is eligible for refinance (i.e. 7a loan, USDA, tax-exempt bond financing, existing 504 project debt)
- ◉ We think all regular 504 economic development goals will apply:
 - ◉ Job creation
 - ◉ Community Development
 - ◉ Public Policy Goal



Use of Proceeds continued:

Eligible Costs

- 85% of **ORIGINAL** loan proceeds must have been used for 504 eligible purposes.
Eligibility is based on original loan only.
 - Subsequent modifications or refinances could have provided cash out for other purposes and the refinance is still eligible for 504.
- 100% of loan proceeds must have been used by and for the operating company
- Closing costs can be included



Use of Proceeds continued:

Documentation Required for Property Financing

- SBA requires documentation of current debt and lien instruments.
- If there has been previous refinance of debt or modifications, it is helpful to have a settlement statement from the original loan to show if the purpose of the original loan met the 85% eligibility test – “substantially all” of the original loan proceeds were for 504 eligible costs.



Use of Proceeds continued:

Cash Out for Business Expenses

(to be confirmed)

- If the project property has sufficient equity, then the borrower can cash out for eligible business expenses up to a maximum 90% loan to value
- Eligible Business Expenses include items such –
 - building repair and maintenance cost (paint, carpet, roof, etc.)
 - utility bills, rent, salaries, inventory
 - pay down/off business line of credit
- Expenses must have been incurred prior to date of 504 application or must be due within 18 months of 504 application



Use of Proceeds continued:

Documentation Required for Business Expenses

- Borrower & CDC must certify the funds will be used to cover business expenses of the Borrower
- Borrower must be able to substantiate the use of funds for business expenses
 - Copies of utility bills, payroll receipts; cancelled checks for rent payments; business credit card bills; etc.
- SBA will be *conducting random samples of supporting documentation* to support these certifications
- CDC should keep documentation in its file



Use of Proceeds continued:

Certifications

- Borrower & Third Party Lender must *certify* the eligible use of proceeds
 - Borrower and Third Party Lender may be requested, prior to closing, to present documentation to support their certifications.
 - If Borrower and/or Third Party Lender is unable to produce documentation, each must certify it has made a diligent search for documents and they are not in its possession.
 - SBA will not cancel an approved loan before disbursement because the documentation cannot be found.
 - However, SBA will expect the Third Party Lender, *if it is the original lending institution (and not a lender who acquired or merged with the original lender)*, to be able to produce the required documentation.
- Third Party Lender must *certify* it will not make the loan without SBA's participation
- BFG & Third Party Lender must *certify* they have no knowledge of a default by the Borrower nor knowledge or information that would point to the likelihood of a default.



Loan Structure - Standard

Third Party Lender Loan - 1st trust *

SBA 504 Loan - 2nd trust, not more than 40% and never in excess of Third Party Lender Loan

Borrower Contribution - not less than 10%

** no longer required to be at least 50% of appraised value*

IMPORTANT:

- Third Party Lender Loan and SBA 504 Loan combined cannot exceed 90% of fair market value of fixed assets securing the loan, plus eligible soft costs.
- Third Party Lender Loan can be less than 50%
- Additional down payment for start-up business and special use asset do not apply to the 504 Refinance Program.



Loan Structure—Debt exceeds appraisal

If the amount of the new loan is not sufficient to pay off entire outstanding debt, must disclose how balance of debt will be handled:

- The Lender of the original debt to be refinanced may:
 1. Forgive all or part of the deficiency - possible tax consequences
 2. Cash from Borrower for all or part of the deficiency
 3. Accept a new Note for the balance which will be subordinate to the liens of the Third Lender and SBA *
- *Three year standby of principal and interest required*
- The Borrower can post additional non-project collateral



Borrower Contribution

- ◉ Equity in eligible fixed assets serving as collateral for the Refinancing Project
- ◉ Equity in any other fixed assets are acceptable to SBA as collateral
 - ◉ Third Party Lender and SBA will be in junior lien positions behind any existing debt
 - ◉ Can include commercial and residential real estate and/or machinery and equipment
- ◉ Cash



Same Institution Debt

Requirements:

- Transcript of entire loan history is required, not just most recent 12 months.
 - Used to determine overall credit worthiness of Borrower
 - Prevents 12 month rehabilitation of otherwise poor credits from qualifying for refinancing program
- Third Party Loan cannot be sold on the secondary market as part of a guaranteed loans



Appraisal & Environmental Requirements

- ◉ Independent appraisals of project assets AND any additional collateral assets are required and must be submitted with SBA application
- ◉ Appraisals must be less than 6 months old
- ◉ Environmentals must be less than 12 months old
- ◉ Appraisals and Environmentals must comply with all regular SBA requirements
- ◉ Appraisals must be addressed to include Third Party Lender, Business Finance Group, and SBA
- ◉ Environmentals must include the SBA reliance letter (for all TSA's, Phase 1 and Phase 2 reports)



SBA 504 Loan Recap

- **SAVE MONEY**
 - Up to 90% financing
 - Financing includes hard and soft costs
- **IMPROVE CASH FLOW**
 - Below market, fixed interest rate
 - Fully amortizing, 20 year loan on 504 portion
- **PRESERVE CASH FOR WORKING CAPITAL**
- **REFINANCE DEBT TO IMPORVE CASH FLOW**
- **GROW BUSINESS**
- **QUICK AND EASY LOAN APPROVAL PROCESS**



CDC's in WV

- Regional Economic Development Partnership
 - Statewide
 - Brian Komorowski – kski@redp.org – 304-232-7722
- Regional Development Funding Corporation
 - Statewide
 - Rebecca MacBlane – rmacblane@rdfc.net – 877-832-6504
- Business Finance Group
 - 4 counties (Berkeley, Hampshire, Jefferson, Morgan)
 - Beth Wilson – ewilson@businessfinancegroup.org – 304-268-0067



For More Information

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